

with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of the Chicago Stock Exchange. All submissions should refer to File No. SR-CHX-95-2 and should be submitted by February 15, 1995.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 95-1784 Filed 1-24-95; 8:45 am]

BILLING CODE 8010-01-M

[Release No. 34-35235; File No. SR-NASD-94-78]

**Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to Exercise Cut-Off Procedures for Expiring Equity Options Contracts**

January 18, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on December 23, 1994, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The NASD proposes to amend Section 63 of the NASD's Uniform Practice Code ("Practice Code") relating to the exercise of expiring standardized equity options contracts. The text of the proposed rule change is available at the Office of the Secretary, NASD, and at the Commission.

**II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the proposed Rule Change**

In its filing with the Commission, the NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The NASD has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

**A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change**

Currently, with regard to expiring standardized equity options, Section 63 of the Practice Code provides that NASD members and their customers are required to indicate their exercise decisions to clearing members no later than 5:30 p.m., E.S.T., on the business day immediately prior to the expiration date of the options ("Exercise Cut-Off Time").<sup>1</sup> this is the latest time by which an exercise instruction<sup>2</sup> may be: (1) Prepared by a clearing member for positions in its proprietary trading account; (2) accepted by a clearing member from a non-clearing member; or (3) accepted by a member from any customer.<sup>3</sup>

The only exemptions to the Exercise Cut-Off Times contained in Section 63 of the Practice Code are: (1) To remedy mistakes or errors made in good faith; (2) to take appropriate action as the result of a failure to reconcile an unmatched option transaction; (3) where exceptional circumstances relating to a customer's or member's

<sup>1</sup> Generally, the rules of the options exchanges provide that equity options may be traded up until the close of business on the last business day before expiration, which is generally the third Friday of the expiration month ("Expiration Friday"). See, e.g., CBOE Rule 11.1 and Phlx Rule 1042.

<sup>2</sup> For customers, an exercise instruction is a notice delivered to a member to exercise an option. for a clearing member of The Options Clearing Corporation ("OCC") or a market maker or floor broker on a national options exchange, an exercise instruction is a notice to OCC to exercise an option that would not be automatically exercised pursuant to OCC's exercise-by-exception procedure ("OCC Rule 805"), or not to exercise an option that would otherwise be automatically exercised pursuant to OCC Rule 805. See infra note 6. The OCC has separate rules regarding cut-off time by which exercise notices must be delivered to OCC by OCC clearing members. The proposed rule change does not in any way affect OCC rules.

<sup>3</sup> In most cases, exercise instructions are electronically transmitted to OCC clearing members through the Clearing Management and Control System ("C/MACS").

ability to communicate exercise instructions to a member (or a member's ability to receive such exercise instructions) prior to the Exercise Cut-Off Time warrant such action; and (4) with respect to options contracts in an account maintained for another member in which only positions of customers of such other member are carried. Members are required to prepare a memorandum of every exercise instruction received from a customer stating the time when such instruction was received. In addition, in the event a member receives and acts on an exercise instruction pursuant to one of the exceptions noted above, the member must prepare a memorandum setting forth the circumstances giving rise to the exception. If the member is relying on either the first or the third exception described above, the member must promptly file a copy of the memorandum with the NASD.

Thus, it is presently a violation of Section 63 of the Practice Code for clearing members to accept exercise instructions after the Exercise Cut-Off Time, except in reliance on one of the exceptions noted above. Because exercise instructions are submitted to the clearing members, without having the audit trail pass directly through the NASD or the particular options exchange(s) trading the expiring option, it is difficult for the NASD to surveil for violations of Section 63. In fact, there have been some situations where members have either delayed making exercise decisions until after the Exercise Cut-Off Time in anticipation of the release of significant news concerning a particular underlying company or, having made exercise decisions prior to the Exercise Cut-Off Time, changed these decisions based upon such news. In one notable situation, the NASD notes that certain firms that anticipated the release of material news regarding a particular company allegedly delayed making their exercise decisions until after the Exercise Cut-Off Time, causing firms who claimed to have been disadvantaged by such conduct to commence a series of highly publicized arbitration proceedings and lawsuits.<sup>4</sup>

Accordingly, in order to enable the options exchanges and the NASD to determine whether options holders have made their final exercise decisions no later than the prescribed Exercise Cut-Off Time and not on the basis of market developments occurring after the Exercise Cut-Off Time, the NASD proposes to amend Section 63 of the

<sup>4</sup> See, e.g., *In re Farmers Group Stock Options Litigation*, Master File No. 88-4994 (E.D.Pa.).

Practice Code to provide for an exercise advice procedure. Specifically, the proposed rule change will alter the existing exercise instruction procedures by requiring that final exercise decisions also be submitted to the relevant options exchange(s) trading a particular equity option. The clearing members will still be responsible for delivering exercise notices to OCC, however, the proposed rule change will allow the NASD, in conjunction with the options exchanges, to accurately document when each exercise instruction was received by a member or clearing member or delivered by a clearing member to OCC.<sup>5</sup> The Exercise Cut-Off Time will still be 5:30 p.m. E.S.T. on the business day immediately prior to the expiration date.

In particular, under the proposal, there will be two means of exercising an expiring equity option: (1) Take no action and allow exercise determinations to be made in accordance with OCC Rule 805;<sup>6</sup> or (2) members may submit a contrary exercise advice (i.e., a notice committing an option holder either to exercise an option that would not otherwise be exercised automatically pursuant to OCC Rule 805, or not to exercise an option that otherwise would be exercised automatically pursuant to OCC Rule 805) ("Contrary Exercise Advice"). A Contrary Exercise Advice will be submitted by NASD members either: (1) To a place designated for that purpose by any national options exchange of which they are a member and where the particular equity option is listed; (2) to a place designated for that purpose by any national options exchange that lists and trades that equity option via a member of such exchange if the member is not a member of such exchange; (3) to any national options exchange of which they are a member and where the equity option is listed via OCC in a form prescribed by OCC;<sup>7</sup> or (4) to any national options

exchange where the equity option is listed via OCC in a form prescribed by OCC, provided the member is a member of OCC. In those instances where OCC Rule 805 has been waived by OCC,<sup>8</sup> the proposal provides that a Contrary Exercise Advice must be submitted prior to the Exercise Cut-Off Time by members wanting to exercise an option that would not have been automatically exercised, or not to exercise an option that would have been automatically exercised, had OCC's exercise-by-exception procedure been in effect.<sup>9</sup> The applicable underlying security price in such instances will be as described in OCC Rule 805(1), which is normally the last sale price in the primary market for the underlying security.

The proposal also requires that members maintaining proprietary or public customer positions in expiring options take necessary steps to ensure that final exercise decisions are properly indicated to the relevant national options exchange with respect to such positions. In addition, the proposal provides that members who have accepted the responsibility to indicate final exercise decisions on behalf of another member also shall take necessary steps to ensure that such decisions are properly indicated to the relevant national options exchange. In this connection, the proposal also provides that members may establish an internal processing cut-off time prior to 5:30 p.m. E.S.T., at which time the member will no longer accept final exercise decisions from its customers in expiring options.

With certain minor modifications,<sup>10</sup> the proposal maintains the current exceptions to Section 63 of the Practice Code. The proposal, however, does add language to Section 63(b)(3) to expressly

members by having to manually process every exercise decision for delivery directly to the relevant options exchange, the procedures and rules being proposed herein will not be implemented by the NASD until OCC submits a written representation to the Commission that C/MACS has been modified as necessary, fully tested, and ready to go on-line to allow members to submit exercise decisions to the options exchanges through C/MACS. The Commission notes that the procedures and rules proposed herein are scheduled for implementation in time for the February 1995 equity option expirations.

<sup>8</sup> This could happen when an underlying security is not traded on its primary market on the trading day immediately preceding an expiration date and, as a result, OCC determines not to fix a closing price for that security. See OCC Rule 805(1).

<sup>9</sup> See *supra* note 6.

<sup>10</sup> Specifically, in order to conform the NASD's proposed rule with the rules of the options exchanges, the NASD proposes to delete the exemption that applies to "option contracts carried in an account maintained for another member in which only positions of customers of such other member are carried."

state that the burden of establishing an exception to the Exercise Cut-Off Time for a proprietary or customer account of a member rests solely on the member seeking to rely on such exception.

In the event a member does not timely submit a Contrary Exercise Advice pursuant to an exception, the responsible member must prepare a written memorandum describing the circumstances surrounding the late submission of the Contrary Exercise Advice and stating the time when such final exercise decision was made or, in the case of a customer, was received. The member must also file a copy of the memorandum with the market surveillance department of the national options exchange trading the option, if it is a member of such exchange, or the NASD's Market Surveillance Department if it is not a member of such exchange, no later than 12:00 p.m., E.S.T., on the business day following that expiration.

Furthermore, in order to highlight the seriousness of violating Section 63 of the Practice Code, the proposed rule language expressly states that submitting or preparing an exercise instruction after the Exercise Cut-Off Time in any expiring equity option on the basis of material information released after the Exercise Cut-Off Time is activity inconsistent with just and equitable principles of trade. The proposal also states that the requirements specified in Section 63(b) will not apply to standardized foreign currency options or standardized index option products.

The NASD represents that the proposed rule change reflects a coordinated effort among all the options exchanges, the NASD, and OCC. In particular, the NASD represents that the proposed exercise advice procedure has been reviewed and endorsed by the Intermarket Surveillance Group ("ISG"),<sup>11</sup> which is in the process of issuing a joint circular explaining the operation of the new exercise cut-off provisions. The NASD notes that the Commission has already approved similar rule proposals from each of the national options exchanges.<sup>12</sup>

<sup>11</sup> ISG was formed on July 14, 1983 to, among other things, coordinate more effectively surveillance information sharing arrangements in the stock and options markets. See Intermarket Surveillance Sharing Group Agreement, July 14, 1983. The members of ISG are the American Stock Exchange, Inc., the Boston Stock Exchange, Inc., the Chicago Board Options Exchange, Inc., the Chicago Stock Exchange, Inc., the Cincinnati Stock Exchange, Inc., the NASD, the New York Stock Exchange, Inc., the Pacific Stock Exchange, Inc., and the Philadelphia Stock Exchange, Inc.

<sup>12</sup> See Securities Exchange Act Release Nos. 34806 (October 7, 1994), 59 FR 52339 (October 17,

Continued

<sup>5</sup> Because OCC's rules are not affected by this rule proposal, the reporting of final exercise decisions as contemplated by the revised rule does not serve to substitute as the effective exercise notice to OCC for the exercise or non-exercise of expiring options.

<sup>6</sup> OCC Rule 805 provides for the automatic exercise of in-the-money options of expiration without the submission of an exercise notice to OCC if the price of the security underlying the option is at or above a certain price for calls or at or below a certain price for puts; and the non-exercise of an option at expiration if the price of the security underlying the option does not satisfy such price levels. See OCC Rule 805.

<sup>7</sup> Even though this may be accomplished by submitting exercise decisions directly to the relevant options exchange, the more likely manner of accomplishing this will be to submit the exercise decisions to the options exchanges through C/MACS. Due to the burden that would be placed on

The NASD believes that the proposal is consistent with Section 15A(b)(6) of the Act. Section 15A(b)(6) requires that the rules of a national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. Specifically, the NASD believes the proposal is consistent with Section 15A(b)(6) of the Act because it should improve the NASD's ability to surveil for and deter violations of the Exercise Cut-Off Time for expiring equity options. In addition, the NASD believes that the requirement that a member must submit a written memorandum describing the circumstances surrounding the late submission of a Contrary Exercise Advice will better enable the NASD to surveil for instances where exercise decisions are impermissibly made or changed on the basis of material information released after the Exercise Cut-Off Time.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The NASD does not believe that the proposed rule change will impose any burden on competition.

#### *C. Self-Regulatory Organization's Statement on Comment on the Proposed Rule Change Received From Members, Participants or Others*

No written comments were either solicited or received with respect to the proposed rule change.

### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory

organization consents, the Commission will:

- (A) By order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File Number SR-NASD-94-78 and should be submitted by February 15, 1995.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 95-1783 Filed 1-24-95; 8:45 am]

BILLING CODE 8010-01-M

[Rel. No. IC-20846; File No. 812-9140]

#### **Anchor National Life Insurance Company, et al.**

January 19, 1995.

**AGENCY:** Securities and Exchange Commission ("SEC" or the "Commission").

**ACTION:** Notice of application for an order under the Investment Company Act of 1940 (the "1940 Act").

**APPLICANTS:** Anchor National Life Insurance company ("Anchor National"), Variable Annuity Account Two ("Separate Account") and Vista Broker-Dealer Services, Inc. ("Vista").

**RELEVANT 1940 ACT SECTIONS:** Order requested under Section 6(c) of the 1940

Act for exemptions from Sections 26(a)(2) and 27(c)(2) thereof.

**SUMMARY OF APPLICATION:** Applicants seek an order to the extent necessary to permit the deduction of mortality and expense risk charges and a distribution expense charge from the assets of the Separate Account under certain individual and group variable annuity contracts (the "Contracts") funded through the Separate Account and under materially similar contracts which may be funded in the future by the Separate Account (the "future contracts"), and from the assets of any other separate account established in the future by Anchor National (the "future separate accounts") in connection with the issuance of contracts that are materially similar to the Contracts.<sup>1</sup>

**FILING DATE:** The application was filed on August 3, 1994, and amended on November 22, 1994.

**HEARING OR NOTIFICATION OF HEARING:** An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing on the application by writing to the Secretary of the Commission and serving the Applicants with a copy of the request, personally or by mail. Hearing requests must be received by the Commission by 5:30 p.m. on February 13, 1995, and should be accompanied by proof of service on the Applicants in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons may request notification of a hearing by writing to the Secretary of the Commission.

**ADDRESSES:** Secretary, SEC, 450 Fifth Street NW., Washington, DC 20549. Applicants, c/o Mark J. Mackey, Esq., Routier, Mackey and Johnson, P.C., 1700 K Street NW., Suite 1003, Washington, DC 20006.

**FOR FURTHER INFORMATION CONTACT:** Patrice M. Pitts, Attorney, or Wendy Finck Friedlander, Deputy Chief, Office of Insurance Products, Division of Investment Management, at (202) 942-0670.

**SUPPLEMENTARY INFORMATION:** Following is a summary of the application. The complete application is available for a fee from the Public Reference Branch of the Commission.

<sup>1</sup> Applicants have agreed to amend this application during the notice period to reflect that the future contracts and the contracts issued by future separate accounts relying on the exemptive relief requested here shall be materially similar to the Contracts.

1994) (order approving File No. SR-PHLX-93-37); 34807 (October 7, 1994), 59 FR 52329 (October 17, 1994) (order approving File No. SR-CBOE-94-06); 34808 (October 7, 1994), 59 FR 52324 (October 17, 1994) (order approving File No. SR-AMEX-94-01); 34810 (October 7, 1994), 59 FR 52334 (October 17, 1994) (order approving File No. SR-PSE-94-12); and 34818 (October 11, 1994), 59 FR 52331 (October 17, 1994) (order approving File No. SR-NYSE-94-12).

<sup>13</sup> 17 CFR 200.30-3(a)(12) (1994).